

THE STATE TAX APPEAL BOARD  
OF THE STATE OF MONTANA

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OCWEN FEDERAL BANK,	)	DOCKET NO.: PT-1999-25
	)	
Appellant,	)	
	)	
-vs-	)	FACTUAL BACKGROUND,
	)	CONCLUSIONS OF LAW,
THE DEPARTMENT OF REVENUE	)	ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,	)	<u>FOR JUDICIAL REVIEW</u>
	)	
Respondent.	)	

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The above-entitled appeal was heard on August 3, 2000, in the City of Havre, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was duly given as required by law.

The taxpayer, represented by Kraig Erickson, property manager with Westfield Properties, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Appraiser Mike Hofeldt, presented testimony in opposition to the appeal. Testimony was presented, exhibits were received, and a schedule for post-hearing submissions was established. The Board then took the appeal under advisement; and the Board, having fully considered the testimony, exhibits, post-hearing submissions, and all

things and matters presented to it by all parties, finds and concludes as follows:

**FACTUAL BACKGROUND**

1. Due, proper and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. The taxpayer is the owner of the property which is the subject of this appeal and which is described as follows:

Holiday Village Mall, 1753 U.S. Highway 2  
(North side of Highway 2 at 19<sup>th</sup> Avenue),  
City of Havre, County of Hill, State of  
Montana; geo code #12-4440-01-3-01-10-0000.

3. For the 1999 tax year, the DOR appraised the subject property at a value of \$60,500 for the land and \$3,834,300 for the improvements.

4. The taxpayer appealed to the Hill County Tax Appeal Board on November 12, 1999, requesting a reduction in value to \$1,900,000 for the improvements, stating:

*See attached MAI appraisal.*

5. In its February 7, 2000 decision, the county board adjusted the value for the improvements to \$2,750,000, stating:

*Upon review of the evidence submitted the board felt the appraisal value should be reduced.*

6. The taxpayer appealed that decision to this Board on March 14, 2000, stating:

*This property has been 50% vacant for a number of years & owner is trying to turn around. However until this can be done we are requesting that the property be evaluated by the numbers it can generate.*

7. During the hearing before this Board, the taxpayer changed his requested value to \$1,675,000 for the improvements.

#### **TAXPAYER'S CONTENTIONS**

Mr. Erickson testified that his firm, Westfield Properties Inc., has been managing the Holiday Village mall for OCWEN Federal Bank since September of 1999, when OCWEN purchased the property. The mall, which was built in 1977 at a cost of \$5 to \$6 million, had been through a bankruptcy proceeding, and a receiver had been appointed for the property by the bankruptcy court. OCWEN, which had previously been the lending institution for the property, was able to "*displace the receiver that was in place for, I believe, seven years,*" according to Mr. Erickson. He testified that OCWEN had set up an entity called OAIC Holiday Village, LLC, that actually owns the property.

Mr. Erickson testified that he was not appealing the \$60,500 value of the land, and, based on information he had

obtained since the county board hearing, he was lowering his requested improvement value from \$1,900,000 to \$1,675,000.

Taxpayer's Exhibit 1 is a four-page document entitled "Holiday Village Mall, Summary of Salient Facts," taken from an appraisal of the subject property prepared in October of 1999 by the firm of CB Richard Ellis, Inc., Valuation & Advisory Services of Salt Lake City, Utah. Page three of the document, the appraiser's letter addressed to OCWEN Federal Bank, states, in pertinent part:

**RE: Appraisal of Holiday Village Mall**

At your request and authorization, CB Richard Ellis, Inc., has prepared a complete appraisal presented in a self-contained appraisal format of the "as is" value of the leased fee estate in the above referenced property. The date of value utilized in our analysis is October 7, 1999.

Holiday Village Mall is an enclosed regional mall located on Highway 2, near that street's intersection with 19<sup>th</sup> Avenue, in Havre, Montana. The mall contains 195,285 square feet of gross leasable area and is anchored by Herberger's. Two other anchor spaces formerly occupied by JC Penney and Woolworths are vacant. As of the effective date, the mall was approximately 47% leased.

Data, information and calculations leading to the value conclusion are incorporated in the report following this letter. The report, in its entirety, including all assumptions and limiting conditions, is an integral part of and inseparable from this letter.

This report may be relied on by Ocwen, its successors and/or assigns and the lender in determining whether to make a loan evidenced by a note which is further secured by the Property. The report may be relied on by any purchaser or assignees of the Property Note in determining whether to acquire the Property Note or an interest therein. In addition the report may be relied on by any rating agency involved in rating securities secured by or representing an interest in the Property Note. This report may be used in connections with materials offering for sale the Property Note, or an interest in the Property Note, and in presentations to any rating agency. With respect to the foregoing, the report speaks only as of the origination date of the report unless specifically updated through a supplemental report.

Based on research and analysis contained in this report, it is my opinion that the current "as is" market value of the leased fee estate in the subject property, as of October 7, 1999, is:

**ONE MILLION FIVE HUNDRED EIGHTY THOUSAND DOLLARS  
(\$1,580,000)**

The above value estimate is subject to the Certification, Limiting Conditions, and Special Assumptions contained herein...

The taxpayer submitted a copy of the complete appraisal as a post-hearing submission.

During the 1999 review of the property, the Department of Revenue had changed the mall's classification from a "regional shopping center" to a "community shopping center." Mr. Erickson explained that a regional mall is typically 500,000 to a million square feet in size, located in a metropolitan area that will draw shoppers from 10-20 miles away, and has a vast tenant mix. The Holiday Village Mall is 295,000 square feet, and Mr. Erickson stated that *"in Havre, the mall needs to be possibly half that size. It was way overbuilt...given the ability to attract tenants into a community of 11,000 people doesn't warrant having a 295,000 square foot mall. For Havre and the outlying communities, this would be our regional mall. But it isn't a typical regional mall in that it doesn't have the big draw that a typical regional mall will have. In Montana, we could probably call Missoula a regional mall and you could call Billings a regional mall...Bozeman is coming close, but still isn't in that category of what would be a typical regional mall. And then a regional mall will attract national tenants, predominantly, and then fill in with local tenants. As you know, in this particular project, we're working hard to attract local tenants...a regional mall will*

*attract those cap rates that I was talking about earlier, ten percent. A community mall in this type of market, that's when your cap rates go up to 12 or 13 percent, associated with the risk that's involved in building a project."*

Taxpayer's Exhibit 2 is a one-page summary of the projected operating budget for Holiday Village Mall for the year 2000. Mr. Erickson testified that they had felt they could lease out spaces at the amounts indicated in the budget and could bring up the total income of the mall considerably, but they were unable to do that. Taxpayer's Exhibit 3 is an actual operating statement for the Holiday Village Mall from January through June of 2000. Actual income was much less than projected, and actual expenses were higher, resulting in an actual net operating income figure through June, 2000 that was considerably less than the projected figure. Taxpayer's Exhibit 4 is a copy of the mall's actual income statement for the month of July, 2000, indicating a net operating loss of \$1,196, compared to a projected July net operating income of \$15,489, as shown in Exhibit 2.

There is a possibility that a large telemarketing firm will lease the space formerly occupied by the J.C. Penney store. Mr. Erickson explained that this lease would be a "gross lease," in which the mall would not have any

recoverable expenses. He further explained that "on a project like this, you have a rent figure that is allocated to each tenant. It's called the gross minimum base rent. That figure is for rent only. On top of that, there's expenses that are pro-rated. On a property such as this, you usually have a pro-ration of those expenses for the common area portions of the mall, meaning landscaping, snow removal, janitorial, etc. And those costs are running roughly about \$4, \$4.50 for the project. We are recovering maybe \$1.03 of those expenses from all the tenants, only because we're not able to charge the full pro-ration because that's more than our rent would be. We're not getting close to \$4.00 on most of our lease rates there."

Mr. Erickson testified that his requested value, which is a higher amount than would be indicated by the actual income and expense figures, was determined partly by the fact that OCWEN has decided to sell the property. OCWEN has an agreement with a group called Sequoia Investments, LLC, which buys distressed properties. Taxpayer's Exhibit 5 is a two-page summary of the "Agreement of Purchase and Sale" between Sequoia and OCWEN. The sale is a cash sale, rather than a contract, and is scheduled to close on August 31, 2000. The agreed-upon purchase price is less than the taxpayer's requested value. Mr. Erickson stated that the new

owners would hire their own property manager, rather than continuing to retain his property management firm.

Mr. Erickson concluded his testimony by stating that *"it's going to take considerable dollars to bring that value even to \$1,675,000, and considerable dollars to be invested in order to bring those tenants in. And, given our history, that's a trend that seems to be continuing, so, I would ask that the cost approach not be looked at as much as the income approach..."*

#### **DOR'S CONTENTIONS**

DOR Exhibit A is a three-page document. The first page contains two photographs of the subject property. The second page, entitled "HOLIDAY VILLAGE NARRATIVE," is reprinted in its entirety as follows:

**I reviewed the Holiday Village Shopping Center on September 29<sup>th</sup> 1999 with John Caven and Tiffany Korb. Many problems and potential problems were pointed out during this visit. However many of these problems had been addressed in previous requested reviews and adjustments.**

**The following is a list of all the adjustments made to date:**

<b>Original Building Value:</b>	<b>\$5,534,078</b>
<b>Previous County Tax Appeal Board reduced value:</b>	<b>\$4,358,948</b>
<b>1993 Review – Lowered the grade from average to fair minus. Increased the depreciation. Removed the basement value for the Woolworth's store.</b>	<b>\$3,963,700</b>
<b>1999 Review – Changed the classification from a Regional Shopping Center to a Community Shopping Center. Increased the depreciation.</b>	<b>\$3,834,300</b>
<b>2000 County Tax Appeal Board reduced value:</b>	<b>\$2,750,000</b>

**The Cost Approach was the only approach we could use because of the lack of Comparable Sales and Income & Expense information.**



Mr. Hofeldt testified that the DOR had to use the cost approach because of the lack of comparable sales and income and expense information. *"We sent out income and expense information to all properties, and we have done that with all sales properties. We got very limited back, and we sent them all again and got very few back. We sent these to Holiday Village under the original ownership of Mitchell, and then when it changed ownership to an insurance company, then to OCWEN, and never received any income and expense information back; so the cost approach was used."*

Page three of Exhibit A, entitled "HOLIDAY VILLAGE APPEAL POINTS," is reprinted in its entirety as follows:

1. The grade of the building has been lowered from Average to (Fair-).
2. The basement value for the Woolworth's building was removed.<sup>1</sup>
3. The classification has been lowered from Regional Shopping Center to Community Shopping Center.
4. Over the years the value of the Holiday Village Shopping Center has been reduced from \$5,534,078 to \$2,750,000.
5. The Department of Revenue appraisals are based on a 1996 base year.

The next reappraisal values will be based on a 2002 base year and put on in 2003.

6. For equalization purposes all the commercial buildings in Hill County were valued using the Cost Approach because of a lack of Comparable Sales (Market Approach) and Income and Expense Data (Income Approach).

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<sup>1</sup>Removed for valuation purposes.

Mr. Hofeldt discussed some of the points listed on page three of exhibit A, including the lowering of the grade of the property from an average to a fair minus. He testified that the basement value for the Woolworth's building was removed because *"they have a lot of problems with that building; they have a lot of water seepage down there, a lot of cracks in the floors; only way you could use it for anything is to go in there and redo the whole thing."* He stated that over the years the DOR has reduced the value of the property from *"about \$5.5 million down to the local appeal board adjustment of \$2,750,000."* He explained that the last reappraisal was based on a 1996 base year, *"which we put on in 1997,"* and the next reappraisal would be done in 2003, based on a 2002 base year. At that time, they will again attempt to obtain income and expense information. Since they had not obtained adequate income and expense information, the cost approach was used. Mr. Hofeldt testified that *"we used it (the cost approach) on everybody, and the economy in Havre has changed over the years. It has not been good, since 1996 on through this year...Our duty is doing a reappraisal based on a base year...and we felt it was only fair to make sure we treat everybody equally; and since we didn't have information, did everything on a cost approach and attempted through AB-26 reviews to lower the*

values where people had different problems with their buildings." He stated that if a commercial building does really well, the DOR would not go out and revalue that building just because their income had increased. It would not be revalued until the next reappraisal cycle.

DOR Exhibit B is a six-page document consisting of computer screen print-outs of the property record card for the subject property. The first page relates to the land value, and Mr. Hofeldt explained that there are 5.5 acres valued at \$11,000 per acre for a total land value of \$60,500. He stated that there were not many commercial sales. "We did have sales on residentials that went up, a little bit of sales on outlying commercials that went up a little bit, so we left, on this last reappraisal, base year 1996, we left the value of the land the same as before." The second page of the exhibit contains general building data. The mall was built in 1977, and Mr. Hofeldt explained that "you can put an effective age in there based on the remodeling of the building to increase the value, and we did not, so it's still 1977." The structure type is 342, a community shopping center, and the grade is shown as a fair minus (F-). The third page of the exhibit shows the physical dimensions of the building, and indicates that the physical condition and the functional utility have been categorized

as two. Mr. Hofeldt explained that *"that's where you get your depreciation, which is fair."* The fourth page of the exhibit describes "other building and yard improvements," including paving, asphalt and lights, all of which were completed in 1977. Mr. Hofeldt testified that *"the paving is really bad out there, and the asphalt's bad, so we lowered the physical and functional on those to poor."*

The property record card shows an economic condition factor (ECF) of 106 percent, which Mr. Hofeldt testified had been applied to all commercial properties in Hill County.

#### **BOARD'S DISCUSSION**

The DOR has relied on the cost approach to value for the subject property. Albright v. Montana Department of Revenue, 281 Mont. 169, 1997, states that "For the valuation of commercial property, CAMAS produces a cost estimate and, in some instances, an income estimate. The income approach to valuation is the preferred method of valuation of commercial properties in Montana." (Emphasis added.) Mr. Hofeldt had testified that he was unable to obtain adequate income and expense information to use an income approach to value.

The Administrative Rules of Montana state:

#### **42.20.107 Valuation Methods for Commercial Properties**

(1) When determining the market value of commercial properties, other than industrial properties, department appraisers will consider, if necessary information is available, an income approach valuation. (Emphasis added.)

(2) If the department is not able to develop an income model with a valid capitalization rate based on stratified direct market analysis method, the band of investment method or collect sound income and expense data, the final value chosen for ad valorem tax purposes will be based on the cost, or, if appropriate, the market approach to value. The final valuation is that which most accurately estimates market value. (Emphasis added.)

The Board recognizes that the DOR has experienced difficulties in obtaining adequate income and expense data in order to value commercial properties using the income approach, not only in Hill County, but in other areas throughout the state. According to statute and administrative rule, the income approach would be a preferable approach to valuing commercial properties, including the subject property.

The Board questions the application of an ECF (economic condition factor) of 106%. According to the **Montana Appraisal Manual, 47.2, ECONOMIC CONDITION FACTOR:**

The economic condition factor is a component of depreciation or market adjustment that is usually applied after normal depreciation. It is normally 1.00 (100%) for the majority of properties where the cost index has been properly established and the depreciation schedules have been adequately calibrated.

It has a role in representing the effects of the economic climate on unique properties in a

boom or bust economy. It can affect individual properties, or it can affect a whole class of properties... In a bust economy that affects certain industries, the market demand for a commercial or industrial facility can turn sour and values can fall substantially, especially if it is a prolonged fall in prices or demands for the services/products the business provides... It is not uncommon for values to drop 30-50% in some instances over a several year period of time...

Mr. Hofeldt had testified that the 106% ECF had been applied uniformly to all commercial properties in Hill County, yet he admitted that there could be differences in, for example, a convenience store and the mall, justifying the application of a different ECF according to the type of commercial property. Evidence and testimony submitted indicated that Havre's economy was, at the time of the reappraisal, and is currently, a "bust" economy. Mr. Hofeldt had testified that *"probably the big decline, as I saw it, was made in 1982, it started to go down, and you're talking about drought and farm economy and a lot of those things. It's been going down slowly but steadily since, I would think."* The appraisal by CB Richard Ellis, Inc., Valuation & Advisory Services, Salt Lake City, UT, entered into the record by the taxpayer as a post-hearing submission, addressed the economic condition of Havre as follows:

...The Hill County population in 1980 was 17,985, and by 1990 it had decreased about 300 people to a level of 17,654. Additionally, the community of Havre lost approximately 600 people in the last decade, and the most recent estimate is that Havre's population approximated 10,700 in 1997. (Page 11)

...Canadian retail trade started to decline in 1993 to a point where current Canadian retail trade is no longer a major factor in the local economy... With the lack of growth in the county, the retail trade sector of Havre has not grown significantly in the last 15 years. (Page 11)

Since 1990, the community has had limited growth in terms of new construction averaging only 4.5 new single-family permits per year. Only six permits for new commercial buildings have been issued since 1990... The lack of new construction is a direct reflection of the limited community growth. (Page 11)

The outlook for growth in the local economy is minimal due to its remote rural location, limited county and city population basis, depressed farm economy and almost non-existent Canadian retail trade traffic. Thus, it is unlikely that the area economy will expand significantly...For these reasons, the general underlying real estate market appears to have minimal potential for growth. All these factors lead to the conclusion that external obsolescence or factors outside most commercial properties are having a definite negative influence on area property values. (Page 12)

Evidence and testimony indicate to the Board that a more accurate ECF to be applied to the subject property would be less than 100%, rather than 106%.

***§15-8-111, MCA. Assessment - market value standard - exceptions.*** (1) All taxable property must be assessed at 100% of its market value except as otherwise provided. (2) (a) Market value is the value at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. Mr. Erickson had testified that, to the best of his knowledge, OCWEN was not forced to sell the property, but was selling it because the mall was not meeting their financial objectives. Sequoia buys distressed properties, and is purchasing the mall with full knowledge of its economic situation. They hope to be able to acquire new tenants, at lease rates lower than OCWEN

had to charge, and to turn the mall into a profitable endeavor. Mr. Erickson had stated that in marketing the mall, OCWEN used a national company *"that sent out inquiries throughout the nation"* regarding the availability of a *"295,000 square foot enclosed mall in Havre, Montana, virtually empty."* It was not an auction sale. Mr. Erickson did not know whether or not a copy of the full appraisal had been presented to the potential buyer at the time of the sale.

The Board studied the CB Richard Ellis, Inc. appraisal. The opinion of the appraiser is that the value of the property as of October 7, 1999, is **\$1,580,000**. Excerpts from the appraisal relating to the area economy have already been presented as a part of this discussion, and other excerpts relating to the appraiser's determination of value follow:

...the somewhat isolated location of Havre and the comparatively small population base create only a limited retail trade area. The simple lack of a strong population base plus the proximity of Havre to the state's second largest community (Great Falls) limits the number of people utilizing the retail/service sector. (Page 11)

... With the lack of growth in the county, the retail trade sector of Havre has not grown significantly in the last 15 years. (Page 11)

...The lack of new construction is a direct reflection of the limited community growth. (Page 11)

The outlook for growth in the local economy is minimal...it is unlikely that the area economy will expand significantly...the general underlying real estate market appears to have minimal potential for growth. All these factors lead to the conclusion that external obsolescence or factors outside most commercial properties are having a definite negative influence on area property values. (Page 12)



The capitalization rate is based largely upon an investor's judgment of the potential for future appreciation to an income stream. The Holiday Village Mall is in a declining trade area and has a recent occupancy near 50%...All considered, we have selected a capitalization rate of 11.50% to apply to the property's projected net operating income for the ensuing 12 months. (Page 68)

The direct capitalization technique resulted in a value of \$1,550,000. The DCF (discounted cash flow) indicated a value of \$1,650,000. Some consideration was given to both approaches. Thus, an "as is" value of \$1,600,000 was concluded via the Income Capitalization Approach. (Page 76)

The appraisal also contains "historical operating statements," including a profit and loss statement for the calendar year of 1997, which indicates a net loss of \$107,138. Mr. Erickson had testified that he did not have information to present to the Board regarding the financial condition of the mall during the DOR's base year of 1996.

As a part of the record, the Board has a sale price for the pending sale in addition to the market value presented in the Ellis appraisal. The **Administrative Rules of Montana**, which relate to using the sale price and/or an independent fee appraisal to establish value, follow, in pertinent part:

**42.20.454 CONSIDERATION OF SALES PRICE AS AN INDICATION OF MARKET VALUE** (1) When considering any objection to the appraisal of property, the department may consider the **actual selling price of the property** as evidence of the market value of the property... (emphasis added)

**42.20.455 CONSIDERATION OF INDEPENDENT APPRAISALS AS AN INDICATION OF MARKET VALUE** (1) When considering any objection to the appraisal of property, the department may consider **independent appraisals of the property** as evidence of the market value of the property... (emphasis added)

The independent fee appraiser's conclusion of value for the subject property is \$1,580,000. The sale price is slightly higher than the value indication from the fee appraisal. Both the appraisal and the sale price are supportive of the taxpayer's requested value of \$1,735,500 (\$60,500 - land; \$1,675,000 - improvements).

#### **CONCLUSIONS OF LAW**

1. **§15-2-301 MCA.** The State Tax Appeal Board has jurisdiction over this matter.

2. **§15-2-301, MCA. Appeal of county tax appeal board decisions.** (4) In connection with any appeal under this section, the state board is not bound by common law and statutory rules of evidence or rules of discovery and may affirm, reverse, or modify any decision.

3. **§15-8-111, MCA. Assessment - market value standard - exceptions.** (1) All taxable property must be assessed at 100% of its market value except as otherwise provided.

4. It is true, as a general rule, that the appraisal of the Department of Revenue is presumed to be correct and that the taxpayer must overcome this presumption. The Department of Revenue should, however, bear a certain burden of providing documented evidence to support its assessed values. (Western Airlines, Inc., v. Catherine Michunovich et al., 149 Mont. 347, 428 P.2d 3, (1967)).

5. Albright v. Montana Department of Revenue, 281  
Mont. 196, 1997.

6. The appeal of the taxpayer is hereby approved, and  
the decision of the Hill County Tax Appeal Board is modified.

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**ORDER**

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject property shall be entered on the tax rolls of Hill County by the Assessor of that county at the value of \$60,500 for the land and \$1,675,000 for the improvements. The appeal of the taxpayer is therefore approved, and the decision of the Hill County Tax Appeal Board is modified.

Dated this 5th day of September, 2000.

BY ORDER OF THE  
STATE TAX APPEAL BOARD

( S E A L )

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GREGORY A. THORNQUIST, Chairman

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JAN BROWN, Member

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JEREANN NELSON, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that on this 5th day of September, 2000, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

Kraig D. Erickson  
V.P. Leasing/Management  
Westfield Properties Inc.  
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Mitchell Building  
Helena, Montana 59620

Hill County Appraisal Office  
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DONNA EUBANK  
Paralegal